

Internal Revenue Service
memorandum

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Br6:DIBower:4/5/89

date: APR 5 1989

to: Assistant District Counsel, Washington, D.C. CC:WAS:TL

from: Chief, Branch 6, Office of Associate Chief Counsel
(International) CC:INTL:Br6

subject: [REDACTED], taxable year [REDACTED]

This memorandum responds to your request of March 24, 1989, for informal technical assistance in the above referenced case.¹ The contents of this memorandum are not to be cited or disclosed to taxpayers without our prior approval.

We conclude that the distribution from petitioner's RRSP is not includible in his gross income for [REDACTED]; rather, only that portion of the RRSP representing income realized by the RRSP during the period when petitioner was a resident alien is includible in his gross income. Accordingly, the deficiency for [REDACTED] should be redetermined by reducing petitioner's gross income by the amount of the RRSP distribution in [REDACTED] and increasing petitioner's gross income by the amount of the RRSP's realized income during [REDACTED].

Background

Prior to [REDACTED], petitioner was a Canadian citizen and resident. In [REDACTED], petitioner became a U.S. resident. For both calendar year [REDACTED] and [REDACTED] petitioner filed a Form 1040 federal income tax return. The [REDACTED] return is not at issue.

In [REDACTED], petitioner established a trust account known as a registered retirement savings plan ("RRSP") under Canadian law. Prior to [REDACTED] petitioner contributed \$[REDACTED] to his RRSP. On [REDACTED], petitioner contributed an additional \$[REDACTED] to his RRSP. On [REDACTED] petitioner's RRSP account was credited with \$[REDACTED] in interest. An additional \$[REDACTED]

¹ For convenience, we use the singular "petitioner" rather than "petitioners" to refer to the husband and wife who are the taxpayers in this case. Also, all dollar amounts in this memorandum are in Canadian dollars.

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██, taxable year ██████████

appears to have been credited on ██████████. On ██████████, petitioner withdrew \$██████████ from his RRSP. This withdrawal either depleted his RRSP account, or left an account balance consisting only of the ██████████ interest credited to the RRSP.

Revenue Canada withheld tax from petitioner's RRSP withdrawal in the amount of \$██████████, a tax rate of ██████████%. Petitioner's federal income tax returns for ██████████ and ██████████ did not include in gross income any amounts attributable to the RRSP, nor did they reflect any deductions for contributions to the RRSP. On ██████████, a notice of deficiency was issued to petitioner which stated, *inter alia*, that the entire withdrawal on ██████████ was includible in petitioner's gross income for calendar year ██████████.

Discussion

The notice of deficiency cites Article XXIX, paragraph 5, of the U.S.-Canada Income Tax Treaty, for its position that the entire RRSP distribution constitutes taxable income for petitioner. The particular paragraph cited is from the current U.S.-Canada Income Tax Treaty, which was ratified on August 16, 1984. In general, the current treaty applies only to taxable years commencing on or after January 1, 1985. It applies to withholding taxes on pension and interest payments which were paid or credited on or after October 1, 1984. See 1986-2 C.B. 258, 269; CCH Tax Treaties, Vol. I., Canada, par. 1301 *et. seq.* (hereinafter CCH). Accordingly, the current treaty is not applicable to the instant case.

The U.S.-Canada Income Tax Treaty potentially applicable to this case is the 1942 treaty, as amended prior to the current treaty's entry into force. See 1943 C.B. 526; CCH par. 1201 (the "Treaty"). There are several provisions of the Treaty which might be applicable to the instant case, and they are discussed below.

Article VIA of the Treaty, added by Article I(c) of the supplemental convention signed June 12, 1950, 1955-1 C. B. 624, 1953-2 C.B. 59; CCH par. 1265, provides that the U.S. may tax a pension derived by petitioner from sources within Canada. This article restates the original Treaty provision concerning treaties enlarges its coverage to include government pensions. Paragraph 7 to the Protocol to the Treaty, 1943 C.B. 526; CCH par. 1223, provides that pensions must be made as periodic payments in order to qualify under

██████████, taxable year ██████████

the Treaty.² The distribution received by petitioner was a lump sum payment, and this is the only form of payment provided by the RRSP. Moreover, a payment from a grantor trust/IRA would not constitute a pension. See discussion on this point below. Accordingly, petitioner's distribution from the RRSP is not a pension under the Treaty.

Article XXIIIE, added by Article I(F) of the supplemental convention signed August 8, 1956, 1961-2 C. B. 289; CCH par. 1264, provides that petitioner is exempt from Canadian tax on amounts credited by a trust (the RRSP) to him from sources without Canada. All income earned by the trust appears to be from sources within Canada. Moreover, the purpose of this provision is to prevent the trust from being a source converter, i.e. it provides that income paid to a taxpayer through a trust is sourced as if paid to the person directly. It does not affect the instant case.

Article XI(1), as amended by Article I(f) of the June 12, 1950 supplemental convention, supra, and Article I(c) of the August 8, 1956 supplemental convention, supra, provides that Canada may tax petitioner on unearned income from Canadian sources at no more than 15%. Canada withheld 15% of petitioner's RRSP distribution.

Article XVII, as amended by the June 12, 1950 supplemental convention, supra, provides that the U.S. may tax its residents on all income (other than certain Canadian government income) under the revenue laws of the U.S. as if the Treaty had not come into effect. Accordingly, since none of the Treaty provisions specifically determine the U.S. tax treatment of the RRSP distribution, the issue must be analyzed under the Code, regulations, and case law.

As a resident alien during 1984, petitioner is taxable on his worldwide income. See section 1.1-1(b) of the Income Tax Regulations. In order to determine whether petitioner's RRSP distribution is includible in his gross income, it is necessary to determine which, if any, of the deferred compensation provisions of the Code apply to an RRSP

² This definition applies to the Treaty both before and after the addition of Article VIA. In general, we as matter of policy will treat lump sum payments as pensions for treaty purposes so long as our treaty partner does so. Under the Treaty, Canada applied the periodic language literally, and as a result the Service also applies it literally.

[REDACTED], taxable year [REDACTED]

distribution. The documents establishing petitioner's RRSP show that it is not a qualified plan under section 401(a) of the Code, and as a foreign trust it cannot be an individual retirement account ("IRA") under section 408.

It is unclear whether the RRSP is a retirement plan which does not meet the requirements of section 401(a) of the Code, or whether it is merely a grantor trust which does not meet the requirements of section 408. Income Taxation in Canada, MacDonald and Cronkwright, vol. 3, par. 41,501 et. seq. (PH 1988), indicates that the Canadian RRSP is similar to an IRA. Furthermore, the provisions of the Canadian revenue laws dealing with RRSPs (sections 146 et. seq. of the Canadian Income Tax Statutes) contain provisions which are very similar to section 408, and do not contain many of the provisions of section 401(a), such as anti-discrimination and mandatory coverage rules. An RRSP is designed only for the benefit of one person (and his or her spouse); the RRSP cannot be expanded to cover additional employees of self-employed persons, as can qualified plans. Canada's version of a qualified plan is a registered pension plan, similar in concept, if not in all details, to our qualified plans under section 401.

Accordingly, the RRSP is appropriately analyzed as if it were an IRA which did not satisfy section 408 of the Code, not as an employees' trust which is part of a plan not meeting the requirements of section 401. Since the RRSP is in form and substance a grantor trust, it should be treated as such and the tax consequences should be determined under sections 671 et. seq.³

The settlor/grantor of a grantor trust described in section 671 of the Code is treated as owning the trust's assets directly for federal income tax purposes. The income earned by the grantor trust is taxed directly to the grantor. In the instant case, petitioner would be considered the grantor of the RRSP.

Only the income earned by the RRSP while the petitioner was a resident alien is taxable to petitioner. Income earned

³ Under the foregoing analysis an RRSP is not an employees trust as that term is used in section 402(b), and thus the provisions of section 402(b) concerning distributions from nonexempt employees trusts would not apply.

_____, taxable year _____

by the RRSP from sources without the United States while petitioner was a nonresident alien, is not includible in petitioner's gross income. It appears that the interest payment on _____ is therefore includible in petitioner's _____ gross income, as well as the interest payment on _____. Actual distributions from the RRSP to petitioner would be treated as a return of either previously taxed income or principal.

The total amount withdrawn by petitioner from the RRSP appears to be less than the amount he contributed. The list of pre-_____ transactions may be incomplete, and unlisted withdrawals may have occurred. Alternatively, the difference could constitute a loss on the disposition on the securities when the RRSP converted them to cash in order to make the _____ distribution to petitioner. PLR 8749008, PLR 8251014, and GCM 34572 collectively indicate that the petitioner's adjusted basis in the RRSP assets should be his adjusted U.S. dollar basis in the assets for U.S. purposes when the assets were acquired, not the basis as computed under foreign income tax laws. The fact that petitioner's basis in his RRSP account for Canadian income tax purposes is zero is irrelevant for federal income tax purposes. Accordingly, the disposition of the RRSP assets in _____ for Canadian dollars may have generated property exchange gain or loss, and an exchange gain or loss as well. In addition, if the Canadian dollars were converted into U.S. dollars other than on the date of the conversion of the RRSP assets to Canadian dollars, there may also be foreign currency exchange gain or loss.

Although these issues have not been raised by either petitioner or by your request, we mention them in case the issue comes up in settlement negotiations. If you need a more complete explanation of these matters, or additional advice on this case, please contact David Bower of this office at 566-9050.



Thomas D. Fuller

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